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SUBJECT: VIETNAM'S REGIONAL OVERVIEW: THE TALE OF TWO NORTHWEST PROVINCES

REF: HANOI 1817

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11. (U) Summary: Northwest Vietnam has traditionally been Vietnam's poorest region. Natural topography, a widely-disbursed population, poor infrastructure, and, in part, provincial governance practices have prevented provinces in this region from keeping apace of economic development occurring elsewhere in Vietnam. Meetings with authorities in two of these provinces revealed their strategies to increase investment and reduce poverty. As the officials recognize, success in both of these areas is dependent upon improved infrastructure development. Both provinces have developed sound strategies, including a focus on growing the region's tourism industry and further developing the Kunming-Lao Cai-Hanoi-Haiphong Corridor, however, much of the population of Lao Cai and Lai Chau Provinces is unlikely to benefit to any great degree from Vietnam's overall economic success in the near future. End summary.

12. (U) This is the second in a series of reports (Reftel) on trips by Embassy and Consulate General personnel to understand better the level of economic development and competitiveness in provinces throughout Vietnam. From October 1-3, members of the Embassy economic section traveled to the far Northwest provinces of Lao Cai and Lai Chau to discuss with provincial government officials, State owned enterprises (SOEs) and private companies the challenges and opportunities facing the region.

13. (U) Vietnam's Northwest provinces, including Lao Cai and Lai Chau, are among Vietnam's poorest. 2006 Vietnam General Statistics Office data shows that regional average per capita incomes amounted to only 54% of the national average (2006 average regional income was \$16.60 per month). Lao Cai and Lai Chau officials reported that 43% and 51% of people in their provinces, respectively, earn less than VND 200,000 (about USD 12) per month - Vietnam's official poverty line for rural areas. The mountainous terrain and widely-disbursed populations present significant challenges for provincial governments as they implement economic development and poverty reduction strategies. To underscore this point, Lai Chau is the least densely populated of Vietnam's 64 provinces, with only 35 people per square kilometer. More than 60% of the province's population is made up of ethnic minorities, who rely primarily on subsistence agriculture for their economic well-being.

14. (U) Innovative strategies and sound governance have allowed parts of the region to prosper, however. Lao Cai's provincial capital, Lao Cai City, lies along the Kunming-Lao Cai-Hanoi-Haiphong corridor, and has benefited greatly from cross-border trade with China. Lao Cai's provincial leadership has taken advantage of the city's location by building modern road and waterway (the city straddles the Red River) infrastructure and developing its

international border gate with China. These moves have helped to attract a number of domestic and foreign (primarily Chinese) firms. The city's economic success has had a spill-over effect, with Lao Cai provincial officials reporting that all 164 of the province's communes are connected by roads, despite the geographic challenges. Lao Cai has also taken advantage of its geography to boost domestic and international tourism, including to the well-known hill station of Sapa and Vietnam's highest mountain, Mount Fansipan. The more than 600,000 tourists to the province in 2006 helped to expand the burgeoning tourism and ancillary service sectors.

#### INFRASTRUCTURE CHALLENGES

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15. (U) Authorities in both provinces pointed to infrastructure development as one of their most costly and difficult challenges. Using central government and provincial funds, the Lao Cai and Lai Chau leadership have each focused on expanding roads, electricity supply and access to clean water for their 585,000 and 340,000 citizens, respectively. Lai Chau's situation is particularly acute, with one official explaining that it requires 2-3 days to reach the province's most remote communities, including a final 50 kilometer stretch over mountains which must be traveled on foot or by horseback. The few roadway connections to neighboring provinces are in poor shape and make travel and overland trade difficult.

16. (SBU) Comparatively, Lao Cai has done better at addressing the infrastructure challenge, and even had perhaps the country's only eight-lane highway leading out of its capital. New construction and industrial development was evident on both sides of the new roadway. One provincial official, however, expressed frustration that the central government had not matched Lao Cai's infrastructure development efforts. He pointed to delays in completion of the planned Lao Cai-Hanoi highway upgrade, which is expected to further boost trade along this corridor. On other essential services, the provincial government reported that by the end of 2007, 82% of Lao Cai's population will be connected to the national electricity grid,

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and 70% will have access to clean water. Lai Chau officials could not provide specific data, but indicated that these figures were lower in their province.

#### SMALL-SCALE AGRICULTURE: BIG EMPLOYER, BIGGER CHALLENGES

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17. (U) Much of the population of both provinces is employed in small-scale or subsistence agriculture. Most products are not developed on a scale to support significant exports, with several exceptions - Lao Cai ships some vegetables and flowers to other parts of the country and Lai Chau exports some tea (mostly unprocessed) and black cardamom. Officials in both provinces noted that small plot sizes, insufficient and outdated processing facilities and low levels of planting technology hamper the development potential of this sector.

18. (U) A representative from the Lao Cai Department of Agriculture and Rural Development expressed concern that following Vietnam's accession to the World Trade Organization (WTO), the "backward techniques" employed by local farmers will make it difficult for them to compete with agricultural producers from other countries. Attracting more technical knowledge and modern processing equipment to the region is therefore a priority for both provincial governments. The Chairwoman of the Lai Chau Farmers Association reported that her members are concerned about competing in the post-WTO market-driven environment. The Association is now concentrating on ways to increase efficiency and productivity among its members. The quality of agricultural goods will also be a challenge, she said, citing the refusal at the border of several recent shipments of agricultural products destined for China.

#### HIGH HOPES FOR TOURISM

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19. (U) Given the challenges cited above, Lao Cai and Lai Chau are hoping to develop their tourism industries in order to keep apace

with economic development in other parts of the country. Lao Cai in particular has emphasized tourism as the lynchpin for its development - touting its natural landscape and ethnic minority villages as key attractions. Officials reported that between 2001 and 2006, this sector has grown 17.5% per year on average and forecast continued growth of 10% per year through 2010 in the provincial economic development plan. Driven by tourism, services make up nearly 40% of Lao Cai's GDP. Provincial authorities are now encouraging businesses to develop the niche market of eco-tourism, with several eco-friendly resorts already operating. The director of the State-owned Lao Cai Tourism Company was optimistic about the future of tourism in the province, but is concerned that attracting enough qualified manpower to support continued growth will be difficult. His company is exploring the possibility of developing a tourism trade school in the province, thereby reducing the need to attract qualified candidates from Hanoi and other cities.

¶10. (U) Lai Chau has looked to neighboring Lao Cai as an example of the potential in the tourism sector. With similar topography and the same draw of ethnic minority villages, the province seems determined to follow Lao Cai's lead. Poor infrastructure, however, is hampering those plans. Lai Chau does not have the benefit of a rail line connecting it to large urban centers, and the roads into the province are in disrepair. To address these issues, the province is exploring the possibility of widening the road connecting it to Lao Cai, and has the longer-term ambition to build an airport and a rail line by 2020. Provincial officials were unable to describe how they intend to draw additional tourists in the near term.

#### INDUSTRIAL DEVELOPMENT ALSO DESIRED

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¶11. (U) The second pillar of the two provinces' development strategies is industrial development. The industrial sector provides 30% of GDP in both provinces, but leaders would like to see that number increase. Lao Cai and Lai Chau possess significant natural and mineral resources, and seek to capitalize on this fact. We visited with a state-owned apatite (a mineral used in fertilizer) mining company in Lao Cai. Already the largest employer in the province with over 3,000 workers, the company's director expects demand for the product to continue to rise as Vietnam's exports of rice and other agricultural products continue to grow. In Lai Chau, black rock, which is popular for use as roofing in countries such as Australia and China, is a key export. Both provinces also hope to attract investors in sectors such as waste treatment, large-scale agricultural production and hydro-electric power. The owner of a medium-sized private construction company in Lai Chau reported that the company has approval to build nine hydroelectric plants, but is

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facing the challenge of accessing modern technology and financial sources.

#### TRADE OPPORTUNITIES ON THE BORDER

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¶12. (U) Lao Cai, with its 203 kilometer long border with China, and Lai Chau with its 273 kilometer long border, have both seen increased cross-border trade. Much of what Vietnam imports across the borders in these provinces is raw materials and industrial inputs such as steel, fertilizer and equipment, according to the General Director of Lao Cai's International Border Gate. Vietnamese exports through Lao Cai and Lai Chau are primarily agricultural products such as tea, coffee and cashews. Officials in both provinces report that the increase in trade has resulted in moderate growth in the number of companies offering trade-related services. In 2006, cross border trade in Lai Chau was \$45 million, but provincial officials aim to double that figure by 2010. The Lao Cai Border Gate General Director quoted cross-border growth rates of 12-15 percent per year over the past three years.

¶13. (U) Along with these opportunities, the long borders also present challenges to the provincial authorities. One key issue has been controlling the spread of diseases, particularly by preventing the smuggling of poultry. At the Lao Cai Border Gate, officials

demonstrated their quarantine system and reported that close cooperation with their Chinese counterparts has resulted in a significant reduction in the number of smuggling cases. Lao Cai and Lai Chau officials claimed that there are few problems with smuggling counterfeit or illicit products across the borders in this region, as the topography here makes it unattractive for potential smugglers.

#### PROVINCIAL GOVERNANCE AND ATTRACTING INVESTMENT

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¶14. (U) Despite sharing many similarities, the two provinces differ significantly in their performance in the 2006 Provincial Competitiveness Index (PCI). Lao Cai, with a composite score of 64.11, ranked number 6 out of 64 provinces in terms of having a favorable business and investment climate. It scored particularly well in the areas of transparency and SOE Bias (meaning that there are few SOEs and a stronger competitive environment). On the other hand, Lai Chau ranked dead last among the 64 provinces, with a composite score of 36.76. Authorities in both provinces were aware of the PCI and their relative scores. Lao Cai officials explained that they have made good governance a priority in attracting investment in an effort to build up the trade corridor connecting Hanoi and Haiphong with Southern China. Lai Chau officials, when asked, were unable to explain the reasons for their low ranking. They recognize that they scored poorly in the transparency and informal charges categories, and noted that they have made it a goal to improve those scores. They pointed to the provincial website as one avenue for improving access to information, though noted that the website should be updated more frequently.

¶15. (U) In addition to the perception that its investment and business climate is Vietnam's worst, Lai Chau does not have the benefit of lying on a highly-developed trade corridor, as Lao Cai does. While many firms choose to locate themselves along the Kunming-Lao Cai-Hanoi-Haiphong corridor for ready transport of their goods, Lai Chau is even more remote and presents logistical challenges for firms to get their products to other markets. For these reasons, Lai Chau officials recognize that they will continue to face difficulties in attracting investment and businesses to the province until both its governance and infrastructure development improve.

#### COMMENT

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¶16. (SBU) Provinces in Vietnam's far Northwest will continue to face significant challenges in keeping up with the rapid economic development occurring elsewhere in Vietnam. In the growing disparity between the "haves" and the "have-nots" in Vietnam, much of this region stands to fall into the latter category. Apart from those living along the highly-developed trade corridor running through Lao Cai Province, the mountainous terrain and poor infrastructure mean that much of the population of Lao Cai and Lai Chau Provinces will have few opportunities to benefit from Vietnam's overall economic success. Leaders in both provinces recognize the challenges they are facing and appear committed to finding ways to overcome those obstacles. Due to natural advantages and sound governance, however, Lao Cai has done a relatively better job of fostering economic development. There are no easy solutions to the difficulties facing this region, and economic growth here will

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require concerted efforts by local and national authorities - including through significant investment in infrastructure development.

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